The Intersection Between U.S. Bankruptcy and Employment Law*

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I. Background: Regulation of Employer Bankruptcies

The intersection between U.S. bankruptcy law and employment law does not fall into any single traditional legal discipline. However, much of the overlap between bankruptcy and employment law involves the Bankruptcy Code. Therefore, an understanding of federal bankruptcy law is essential to a discussion of worker rights in employer bankruptcies.[1]

The United States Constitution affirmatively requires Congress to establish "uniform Laws on the subject of Bankruptcies throughout the United States."[2] The theory is that state-by-state bankruptcy regulation would be insufficient to protect creditors and to carry out the three goals of any comprehensive bankruptcy policy: (1) to achieve a fair distribution of a debtor's assets among creditors, (2) to give debtors a genuine fresh start, and (3) to administer the bankrupt's estate economically.[3]

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1. In the early days of the Wagner Act, before the courts had worked out the respective roles of bankruptcy referees and the NLRB, bankruptcy courts played an even greater role in adjudicating employment issues than they do today. *See, e.g.*, CHARLES M. BUFFORD, THE WAGNER ACT: EMPLOYEE AND EMPLOYER RELATIONS § 70, at 176-80 (1941). *Employee* bankruptcies, which do have some effect on this topic, are treated in this article at section VI.
2. U.S. CONST., art. I, § 8, cl. 4.
3. 9 AM. JUR. 2d *Bankruptcy* § 5, at 109 (1991).

The U.S. Bankruptcy Code (codified at Title 11 of the United States Code) contains eight chapters, of which the most relevant to employment law are chapters 7 and 11. Chapter 7 deals with complete liquidations of all of a debtor's assets.[4] Under chapter 7, a debtor generally ceases doing all business and distributes all its assets among its creditors.[5] Chapter 11, on the other hand, deals with "reorganization[s]."[6] Chapter 11 reorganizations aim to "rehabilitat[e]" the debtor and give the debtor a "breathing spell" in order to consolidate debts and manage them in an orderly way.[7] Chapter 11 debtors operate under a trustee and seek to emerge from bankruptcy to operate again in their own right.[8]

This article examines the U.S. Bankruptcy Code provisions which come into play when employees seek to recover compensation from a bankrupt employer. The article next addresses rejection of a collective bargaining agreement by a bankruptcy trustee, and how the "automatic stay" provision of the Bankruptcy Code applies to employment-context administrative hearings. The discussion then turns to issues regarding employer insolvencies outside of the Bankruptcy Code. Finally, the effect of *employee* bankruptcies and insolvencies on employers is examined.

II. Employee Compensation in an Employer's Bankruptcy

The most important employment issue regarding a corporate bankruptcy is the employees' right to receive owed compensation. "Compensation" breaks down into four groups: (1) wage claims, (2) claims for pay under terminated employment contracts, (3) vacation (and holiday) pay and severance pay claims, and (4) claims for contributions to employee benefit plans.

A. *Wage Claims*

The Bankruptcy Code sets out nine classes of "priorities" that must be paid from a bankrupt's estate before the rest of the estate can be divided up to settle claims of general creditors.[9] The third of these nine classes of priorities is for:

> [A]llowed unsecured *claims for wages, salaries, or commissions, including vacation, severance, and sick leave pay*—(A) earned by an individual *90 days* before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first; but only (B) to the extent of *$2,000* for each such individual.[10]

4. 11 U.S.C. §§ 701–66 (1988).
5. *Id.*
6. 11 U.S.C. §§ 1101–74 (1988).
7. 9B AM. JUR. 2d *Bankruptcy* § 2372, at 171–72 (1991).
8. *See* 11 U.S.C. §§ 1101–74 (1988).
9. 11 U.S.C. § 507. In Chapter 7 bankruptcies, priority claims must be paid, in descending order of priority, before any other claims. In Chapter 11 cases, priority claims must be paid in full.
10. 11 U.S.C. § 507(3) (emphasis added).

As the plain wording of this statute implies, wage claims extending back beyond ninety days and wage claims for over $2,000 are general debts *not* subject to any priority.[11]

In the United States a strong, almost paternalistic policy exists allowing employees to collect accrued wage claims.[12] Bankruptcy law accommodates this policy procedurally, for example by allowing trade unions to sue on behalf of employees[13] and by allowing the bankruptcy courts to authorize immediate payment of employee wage claims even for wages earned before a bankruptcy petition was filed.[14] Employees therefore can get paid without the delays inherent in court procedures.

However, the policy in favor of paying employees does not extend to "contractors" not under the traditional employer/employee relationship with the bankrupt.[15] Those who serviced a bankrupt often try to invoke the "third priority" for wages, claiming their services were effectively work for "wages." While all such cases turn on their particular facts, courts are quick to characterize a service provider's relationship as that of a contractor, and therefore not subject to the "third priority." In one such case, a creditor company that provided a bankrupt with temporary employment help was held not to have a priority wage claim.[16] Similarly, a trucking company that provided trucking services to an ultimately bankrupt customer was held not to have a wage claim—even though the contractor made a convincing factual argument that its truck drivers were actually employees of the debtor.[17] In another case, even an outside salesman owed commissions was unable to invoke the "third priority"; the salesman was held to be an independent contractor whose commissions were not "wages."[18]

Because the "third priority" for wages allows a priority only for those wages earned "within 90 days before the date of the filing of the petition or the date of cessation of the debtor's business, whichever occurs first," disputes also arise over the meaning of "cessation of busi-

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11. *See, e.g.*, Nathanson v. NLRB, 344 U.S. 25 (1952) (National Labor Relations Board back pay award in favor of employees of bankrupt corporation held not priority debt under former U.S. Bankruptcy Act).

12. *See, e.g.*, In re St. Louis Globe-Democrat, 86 B.R. 606, 608 (Bankr. E.D. Mo. 1988) (Trustee's position "as to the employees' base [pre-petition] wages is that they should be allowed as expenses necessary to the preservation of the estate. The Court agrees with this position since it is patent that without the sacrifice, loyalty and hard work of the . . . employees, the [employer] would have met an even earlier demise.").

13. *See, e.g.*, U.S. Truck Co. v. Teamsters Nat'l Freight Indus. Neg. Comm., 89 B.R. 618 (Bankr. E.D. Mich. 1988).

14. *See, e.g.*, In re Gulf Air, Inc., 112 B.R. 152 (Bankr. W.D. La. 1989).

15. *See infra* notes 16–18 and accompanying text.

16. *In re* Grant Indus., Inc., 133 B.R. 514 (Bankr. W.D. Mo. 1991).

17. *In re* Dahlman Truck Lines, Inc., 59 B.R. 218, 221 (Bankr. W.D. Wis. 1986); *see id.* ("[e]ven if [the trucking contractor] had established that its employees were actually employees of [the bankrupt], the result would not change . . . [because] there is no suggestion that the employees executed wage assignments in [the contractor's] favor").

18. *In re* American Shelter Sys., Inc., 40 B.R. 793 (Bankr. W.D. La. 1984).

ness."[19] In one 1990 case, *In re Rau*,[20] a debtor had operated two quite distinct businesses: a mine and a restaurant. The mine closed down in 1983, but the restaurant continued operating for four more years until 1987, when the debtor finally petitioned for bankruptcy.[21] Some of the miners, still owed wages from the mine's last days back in 1983, brought a wage claim in the 1987 bankruptcy.[22] The court held, notwithstanding the sharp operational distinction between a mine and a restaurant, that the employer as a total entity had operated until 1987.[23] The miners' wage claims dating back to 1983 therefore extended too far beyond the ninety-day period.[24]

This "third priority" for wage claims involves claims for wages earned *before* the debtor filed its bankruptcy petition; *post-petition* wage claims are entirely different.[25] The *first* priority under U.S. bankruptcy law (which of course takes precedence over the "third priority" for wage claims) is for "administrative expenses."[26] This encompasses "the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case."[27] Accordingly, case law gives a clear "first priority" to employees properly working for a bankrupt estate after a bankruptcy petition filing.[28]

B. *Claims for Pay under Terminated Employment Contracts*

The foregoing shows how Bankruptcy Code provisions render wage claims up to $2,000 for pay earned in the ninety days before an employer petitions for bankruptcy or ceases operations subject to a "third priority," and render wages for post-petition earnings subject to a first priority. Claims for *other* compensation (pre-petition claims beyond ninety days and $2,000) simply become general debts of the estate. However, a special bankruptcy law provision exists limiting claims for pay under "terminat[ed] employment contracts."[29] The Bankruptcy Code expressly rejects all claims:

> of an employee for damages resulting from the termination of an employment contract, [when] such claim[s] *excee[d]*—(A) the compensation

19. 11 U.S.C. § 507(3).
20. 113 B.R. 619 (9th Cir. 1990).
21. *Rau*, 113 B.R. at 620.
22. *Id.*
23. *Id.*
24. *Id.*
25. 11 U.S.C. § 507(3).
26. *Id.* § 507(1).
27. *Id.*; 11 U.S.C. § 503(b)(1)(A). Without this first priority for administrative expenses, no one, including bankruptcy lawyers, would be willing to perform services for a bankrupt's estate.
28. *See, e.g.*, *In re* Valley Concrete Corp., 118 B.R. 174 (Bankr. D.R.I. 1990); *In re* Konidaris, 87 B.R. 846 (Bankr. E.D. Pa. 1988).
29. 11 U.S.C. § 502(b)(7).

> provided by such contract, without acceleration, *for one year* following the earlier of—(i) the date of the filing of the petition; or (ii) the date on which the employer directed the employee to terminate, or such employee terminated, performance under such contract; plus (B) any unpaid compensation due under such contract, without acceleration, on the earlier of such dates.[30]

This provision addresses fixed-term employment contracts which guarantee employment into the future, limiting claims under such contracts to one year's wages. As a practical matter, however, this provision is not as important as it might seem, because fixed-term employment agreements are rare, and even collective bargaining agreements—many of which might be interpreted to guarantee future employment absent just cause for dismissal—are increasingly rare: About 10 percent of the nongovernment U.S. work force is unionized and protected by a collective bargaining agreement.[31]

Nevertheless, cases under this "terminat[ed] employment contracts" section do arise, such as those cases involving highly compensated executives who had the foresight and bargaining power to secure definite-term contracts. In *In re Murray Industries*,[32] a bankruptcy court addressing such an employment contract said the Bankruptcy Code's "terminat[ed] employment contracts" provision exists "to protect the general [bankruptcy] estate from being saddled with exorbitant damage claims for breach of employment contracts at the expense of the other creditors of the estate."[33] Nevertheless, "the clear and unambiguous language of the Section" required the court to allow a one-year front-pay claim in favor of an executive vice president who earned $200,000 per year.[34]

In a more sweeping move, one bankruptcy court held that the "terminat[ed] employment contract" rule applies to cut off *back pay* claims at the one-year point.[35]

C. *Vacation and Severance Pay Claims*

In the United States, statutes generally do not compel vacation (including holiday) pay, but employers generally agree to pay some vacation pay and to pay for certain not-worked holidays. Unlike in Eu-

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30. 11 U.S.C. § 502(b)(7) (emphasis added).

31. In 1991, 11.9% of private nonagricultural workers in the United States were union members, and 13.1% were represented by unions. STATISTICAL ABSTRACT OF THE UNITED STATES 1992, at 422 (Table 672) (1992). These figures are suspected to have declined since 1991.

32. 114 B.R. 749 (Bankr. M.D. Fla. 1990).

33. *Murray Indus.*, 114 B.R. at 752.

34. Id. at 750, 752.

35. *In re* Wheeling-Pittsburgh Steel Corp., 113 B.R. 187, 192-93 (Bankr. W.D. Pa. 1990), *vacated*, 147 B.R. 874 (Bankr. W.D. Pa. 1992). The precedential effect of this decision, however, is minimal, in light of the bankruptcy court's subsequent approval of a settlement agreement and holding that its earlier opinion "is hereby vacated as moot and has no precedential value." 147 B.R. at 875.

rope, severance pay in the United States is generally *not* statutorily mandated, and employers do not usually grant even contractual rights to severance pay. However, notable exceptions to this exist, especially under many collective bargaining agreements.

As to an employee's right to collect vacation (including holiday) pay and severance pay from a bankrupt employer, the applicable rules are the same as the rules for wages—that is, the governing sections of the Bankruptcy Code are those setting out the "third priority" for "wages" up to $2,000 earned within ninety days of the bankruptcy filing, the "first priority" for administrative wages earned after the bankruptcy petition is filed, and the one-year limit on damages for breach of employment contracts.[36] Therefore, the analysis for vacation (including holiday) pay and severance pay is conceptually the same as that for regular wages. In practice, however, these special classes of compensation raise special problems.

A persistent problem under several branches of employment law is how and when special classes of compensation vest and become enforceable employee rights. Generally, there is no single doctrine governing whether vacation/holiday pay is earned incrementally (over time), is earned on a certain accrual date, or is earned on the day of the vacation or holiday. Similarly, there is no single doctrine governing whether severance pay is earned incrementally, is earned after an eligibility period passes, or is earned upon severance. How and when these special classes of pay are earned is a matter of the operative understanding or employment agreement between every specific employer and its employees.[37]

Therefore, courts are often compelled to look to the parties' understanding. Not surprisingly, this leads to complex and unpredictable results. In one case[38] an employer's vacation policy required employees to work a full year in order to *accrue* vacation time to be used the next year; under the rule, employees also had to work one day in the next year for the vacation time to vest.[39] When the employer petitioned for bankruptcy, the out-of-work employees asked the bankruptcy court to award them the current year's vested vacation pay in cash, as "earned wages" under the third priority.[40] The bankruptcy court judge agreed that the full year's vacation pay was "earned wages,"[41] but the appeals court reversed, ruling:

36. 11 U.S.C. §§ 507(3), 502(b)(7).
37. *See, e.g.*, *In re* Allegheny Int'l, Inc., 118 B.R. 276, 278 (Bankr. W.D. Pa. 1990).
38. *In re* Northwest Eng'g Co., 863 F.2d 1313 (7th Cir. 1988).
39. *Id.* at 1313.
40. *Id.*
41. *Id.*

> Vacation pay is "earned" continuously as work is done. The worker receives third priority treatment for benefits "earned" in the 90 days before filing—provided always that the employer is indebted to the worker in at least this sum, a question that depends on the contract and state law. The debt [for vacation pay] in this case is conceded; only the priority is debated. That priority is, as § 507(a)(3) provides, for 90 days' worth of vacation pay.[42]

The rest of the year's vacation pay became an ordinary debt of the estate not subject to any priority.[43]

Severance pay presents an even more complicated question because contractual severance pay schemes vary widely. In one case[44] an employee had a personal employment agreement that guaranteed that if he were terminated without reasonable cause, his employer would pay him his regular salary for "three months following . . . termination." The employee, terminated because of the employer's bankruptcy, claimed his severance pay obligation was a wage claim entitled to the third priority.[45] Yet the court ruled that the three-month pay-out provision was merely an accounting clause that did not fix the date the severance *obligation* arose.[46] According to the court, the severance pay obligation had been fixed on the date the parties signed the original personal employment contract, which had long preceded the ninety days before the bankruptcy filing.[47] The court therefore ruled the employee's claim was "an unsecured claim only,"[48] not subject to any priority. However, analytically the court just as easily could have held the employee's right to receive severance pay never became "fixed" until the day he was terminated, because the employer might *never* have terminated the employee without reasonable cause. Under this logic, the employee should have been able to make out a priority wage claim for the severance pay.

Yet more difficult severance pay cases involve bankrupt employers who ask employees to keep working after they file their bankruptcy petitions. These employees, when ultimately terminated, may claim the severance pay they earned during the reorganization period is entitled to *first* priority status, as "costs and expenses" of estate administration. Courts do tend to agree with this analysis, but they carefully limit the amount of severance pay eligible for first priority treatment to that severance pay *actually earned* after the bankruptcy petition filing.[49]

42. *Id.* at 1319. A similar decision is *In re* Columbia Packing Co., 35 B.R. 447 (Bankr. D. Mass. 1983).

43. *Northwest Eng'g*, 863 F.2d at 1314.

44. *In re* General Info. Services, Inc., 68 B.R. 419, 420 (Bankr. E.D. Pa. 1986).

45. *Id.* at 420.

46. *Id.* at 421.

47. *Id.*

48. *Id.*

49. See, for example, cases cited in 2 PATRICK HARDIN, THE DEVELOPING LABOR LAW 1755–56 (3d ed. 1992) [hereinafter HARDIN].

There is a split among the U.S. circuit courts of appeals on how to treat such post-petition severance claims.[50]

D. *Claims for Employer Contributions to Employee Benefit Plans*

We have seen that the bankruptcy law "first priority" for administrative expenses covers properly earned post-petition compensation, and the "third priority" covers certain other wage claims.[51] The *fourth* priority, meanwhile, covers "unsecured claims for contributions to an employee benefit plan."[52] These claims are entitled to fourth priority status, though only to the extent they are based on services rendered within 180 days "before the date of the filing of the petition or the date of the cessation of the debtor's business, whichever occurs first."[53] In addition, the amount of these claims can only be for "the difference between the $2,000 maximum wage priority times the number of employees covered under the plan, minus the actual distributions to such employees under the wage priority provision."[54]

"Employee benefit plan" is broadly defined under the Employee Retirement Income Security Act of 1974 (ERISA),[55] the statute that defines and regulates most employee benefit plans. Reported decisions under the "fourth priority" for "benefit plan contributions" have held that employer-paid premiums for health, life, and disability insurance all fall under this fourth priority.[56] Even actual accrued medical expenses of former employees fit under this priority if the employer had a self-insured program for reimbursement of employee medical expenses.[57]

Other cases under this fourth priority involve the definition of "cessation of business."[58] When employers close down various plants well before filing a bankruptcy petition, affected employees try to seize upon their facility's closing date as a "cessation of business" to have the

50. For a description of this split in the circuits and citations to the cases, see HARDIN, *supra* note 49, at 1755–56. Additionally, courts treat "bonus" payments as similar to severance pay. *See, e.g.*, *In re* Eye Contact, Inc., 97 B.R. 990 (Bankr. W.D. Wis. 1989).

51. 11 U.S.C. § 507.

52. 11 U.S.C. § 507(a)(4); *see* Columbia Packing Co., 47 B.R. 126 (Bankr. D. Mass. 1985).

53. 11 U.S.C. § 507(a)(4).

54. HARDIN, *supra* note 49, at 1754 (paraphrasing 11 U.S.C. § 507(a)(4)(B)). This "fourth priority" statute legislatively overturns a 1959 U.S. Supreme Court decision which had ruled that fringe benefits were not to be treated under the wage priority. United States v. Embassy Restaurant, 359 U.S. 29 (1959). *See In re* Saco Local Dev. Co., 711 F.2d 441 (1st Cir. 1983).

55. 29 U.S.C. §§ 1001–1461 (1988).

56. *In re* Saco Local Dev. Corp., 23 B.R. 644 (Bankr. D. Me. 1982).

57. *In re* Jet Fla. Sys., Inc., 80 B.R. 544 (S.D. Fla. 1987).

58. *See, e.g.*, Davidson Transfer v. Teamsters Pension Trust Fund, 817 F.2d 1121 (4th Cir. 1987); *In re* Bodin Apparel, Inc., 56 B.R. 728 (S.D.N.Y. 1985), *aff'g* 46 B.R. 555 (Bankr. S.D.N.Y. 1985); *In re* Danborn Contracting Co., 56 B.R. 8 (Bankr. N.D. Ohio 1985); *In re* Adcock Excavating, Inc., 42 B.R. 84 (Bankr. N.D. Ill. 1984).

180-day clock turned back to when they were still working. However, as with wage claims, bankruptcy courts addressing these benefit claims generally hold that a "cessation of business" does not include a mere closure of less than all the employer's businesses.[59]

Other litigated issues regarding the fourth priority for employee benefit plans include a bankrupt employer's withdrawal from a multi-employer pension plan and the treatment of payments due an employee benefit fund after an employer filed a bankruptcy petition.[60]

Related to the issue of employer contributions to employee benefit plans is the question of the bankruptcy trustee's continued obligation to pay insurance benefits to retired employees. An extremely long section of the Bankruptcy Code, section 1114, addresses "payment of insurance benefits to retired employees."[61] Rather than offer any simple solution applicable to all bankruptcies, the section sets out a procedure by which retired employees can voice their concerns as to how a bankrupt former employer should handle insurance plans covering them.[62] Substantial litigation has arisen under this section as retirees jockey for a piece of the bankrupt's estate.[63]

III. Trustee's Rejection of Bankrupt's Collective Bargaining Agreement

Another key issue in the overlap between bankruptcy law and employment law is the long and complex line of authority governing a bankruptcy trustee's power to reject a bankrupt company's collective bargaining agreement.[64] A 1984 U.S. Supreme Court decision had held that bankruptcy courts can allow bankruptcy trustees (debtors-in-possession) to reject collective bargaining agreements if the trustee can show the specific agreement burdened the estate, if the equities weigh in favor of the rejection, and if rejection furthers the purpose of the bankruptcy.[65] Limiting if not fully overruling this Supreme Court case, Congress quickly adopted section 1113 of the Bankruptcy Code, which

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59. *See, e.g.*, cases cited *supra* note 58.

60. *See* discussion and cases cited in HARDIN, *supra* note 49, at 1754–55. Incidentally, the U.S. Supreme Court has held that a bankrupt employer's interest in an ERISA-qualified benefit plan is excludable from the bankruptcy estate. Patterson v. Shumate, 112 S. Ct. 2242 (1992).

61. 11 U.S.C. § 1114.

62. *Id.*

63. *See, e.g.*, United Steelworkers v. Unimet Corp., 842 F.2d 879 (6th Cir. 1988), *cert. denied*, 488 U.S. 828 (1988); *In re* White Farm Equip. Co., 788 F.2d 1186 (6th Cir. 1986); *In re* Ionosphere Clubs, Inc., 134 B.R. 515 (Bankr. S.D.N.Y. 1991); *In re* Doskocil Cos., 130 B.R. 870 (Bankr. D. Kan. 1991); *In re* Garfinckles, Inc., 124 B.R. 3 (Bankr. D.D.C. 1991); *In re* GF Corp., 115 B.R. 579 (Bankr. N.D. Ohio 1990), *modified*, 120 B.R. 421 (Bankr. N.D. Ohio 1990).

64. A thorough summary of this area appears at HARDIN, *supra* note 49, at 1756–64.

65. NLRB v. Bildisco & Bildisco, 465 U.S. 513 (1984).

now governs the rejection of collective bargaining agreements in bankruptcy.[66]

Section 1113, a lengthy Bankruptcy Code section which "is not a masterpiece of draftsmanship,"[67] effectively sets out nine requirements a court must find before it will approve a trustee's proposed rejection of a collective bargaining agreement:

> 1. The debtor in possession must make a proposal to the Union to modify the collective bargaining agreement.
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> 2. The proposal must be based on the most complete and reliable information available at the time of the proposal.
>
> 3. The proposed modifications must be necessary to permit the reorganization of the debtor.
>
> 4. The proposed modifications must assure that all creditors, the debtor and all of the affected parties are treated fairly and equitably.
>
> 5. The debtor must provide to the Union such relevant information as is necessary to evaluate the proposal.
>
> 6. Between the time of the making of the proposal and the time of the hearing on approval of the rejection of the existing collective bargaining agreement, the debtor must meet at reasonable times with the Union.
>
> 7. At the meetings the debtor must confer in good faith in attempting to reach mutually satisfactory modifications of the collective bargaining agreement.
>
> 8. The Union must have refused to accept the proposal without good cause.
>
> 9. The balance of the equities must clearly favor rejection of the collective bargaining agreement.[68]

While bankruptcy courts seem otherwise-inclined to approve rejections of collective agreements, these nine requirements impose a high burden on bankruptcy trustees. Case law shows that unions are quick to litigate against trustees who attempt to reject agreements.[69] Therefore, any trustee contemplating rejection must ensure a good argument exists as to the presence of each of these nine factors. In any event, the case law makes clear that section 1113 does not elevate claims under *unrejected* collective bargaining agreements to any special preferred status.[70]

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66. 11 U.S.C. § 1113; *see* NLRB v. Manley Truck Line, Inc., 779 F.2d 1327 (7th Cir. 1985).

67. *In re* American Provision Co., 44 B.R. 907, 909 (Bankr. D. Minn. 1984).

68. *Id.*

69. *See, e.g.*, *In re* Unimet Corp., 842 F.2d 879 (6th Cir. 1988); Wheeling-Pittsburgh Steel Corp. v. United Steelworkers, 791 F.2d 1074 (3d Cir. 1986); Yorke v. NLRB, 709 F.2d 1138 (7th Cir. 1983); *In re* Indiana Grocery Co., 138 B.R. 40 (Bankr. S.D. Ind. 1990).

70. *See, e.g.*, *In re* Armstrong Store Fixtures Corp., 139 B.R. 347 (Bankr. W.D. Pa. 1992); *In re* Ohio Corrugating Co., 115 B.R. 572 (Bankr. N.D. Ohio 1990); *In re* Murray Indus., Inc., 110 B.R. 585 (Bankr. M.D. Fla. 1990).

IV. The Automatic Stay Provision as Applied to Employment-Context Administrative Procedures

Another aspect of bankruptcy law not related to direct benefit claims is how the Bankruptcy Code's automatic stay provision applies to employment-context administrative procedures.

In the United States, when an entity files for bankruptcy, most litigation and similar proceedings are automatically stayed (suspended) under a section of the Bankruptcy Code which stays all "judicial, administrative, or other action[s] or proceeding[s] against a debtor that was or could have been commenced before the commencement of the [bankruptcy] case . . . , or [actions] to recover a claim against the debtor that arose before the commencement of the [bankruptcy] case."[71] The Bankruptcy Code, however, contains several exceptions to this stay provision; one exception exempts "the commencement or continuation of an action or proceeding by a governmental unit to enforce such governmental unit's *police or regulatory power*."[72] For centuries, United States law has wrestled with the concept of what falls under the government's "police or regulatory power."[73] However, as regards proceedings of the National Labor Relations Board (NLRB) (administrative proceedings involving union-management "unfair labor practices" and union elections), the law is settled: The NLRB is a governmental unit enforcing police power, so its proceedings come under the exception to the automatic stay.[74]

A more complex issue arises regarding state-agency workers' compensation proceedings (by which the states award employer-funded payments to employees injured on the job). One thoroughly reasoned opinion holds that state workers' compensation proceedings, like NLRB proceedings, are an exercise of the states' police power, and therefore these proceedings also come under the exception to the Bankruptcy Code automatic stay.[75]

In any event, employment-context proceedings which continue under the "police power" exception to the automatic stay continue regarding *liability* only. *Enforcement* proceedings—by which claimants collect damages awarded in the tribunal—will always be stayed. As such, money judgments arising out of administrative proceedings become debts of the bankruptcy estate. They are not subject to any special prior-

71. 11 U.S.C. § 362(a)(1).
72. 11 U.S.C. § 362(b)(4) (emphasis added).
73. The author has elsewhere discussed and cited authority regarding the ambiguity of what the "police power" label encompasses. Donald C. Dowling, Jr., *General Propositions and Concrete Cases: The Search for a Standard in the Conflict Between Individual Property Rights and the Social Interest*, 1 J. LAND USE & ENVTL. L. 353, 365–69 (1985).
74. NLRB v. P*I*E Nationwide, Inc., 923 F.2d 506 (7th Cir. 1991); *see also* NLRB v. Better Bldg. Supply Corp., 837 F.2d 377 (9th Cir. 1988).
75. *In re* Mansfield Tire & Rubber Co., 660 F.2d 1108 (6th Cir. 1981); *see also In re* Webster, 126 B.R. 4 (Bankr. D. Me. 1991).

ity merely because they emanate from a tribunal exercising "police power."

V. Insolvency Issues

Until now this article has dealt with employers' actual bankruptcy filings. Some other important insolvency issues merit attention which, although not strictly creatures of bankruptcy law, often come into play when employers undergo financial hardship or insolvency.

A. *Financial Record Disclosure in Collective Bargaining*

Employers in bargaining relationships with trade unions are subject to a long-standing doctrine requiring them to disclose financial records whenever they claim, in collective bargaining, an "inability to pay" certain compensation levels.[76] Under this doctrine an employer claiming it cannot afford union compensation demands must open its books to the union.[77] This arises both when a union seeks a compensation increase from the employer and when an employer seeks a compensation decrease—"concessions"—from the union.[78]

This financial disclosure rule grows out of the provisions in U.S. labor law that require collective bargaining in good faith.[79] The theory is that when an employer pleads inability to pay, good faith requires the employer to back this claim up with documents.[80] Otherwise the union will be in the impossible situation of having to dispute a claim without facts. For decades the NLRB and the federal courts have struggled with this doctrine, litigating a myriad of issues on it.[81] Disputes often turn on whether an employer had actually pleaded an inability to pay, or had merely expressed a desire to increase profits and an *unwillingness* to pay.[82]

For example, in a 1992 case an employer seeking "concessions" told its union that its economic outlook was not "too rosy."[83] The employer, however, disavowed making any express claim of an inability to pay increased compensation.[84] The court found the employer had "stated that competition from both foreign producers and other plants was the principal cause of the plant's troubles, and Union concessions were

76. *See, e.g.*, NLRB v. Truitt Mfg. Co., 351 U.S. 149 (1956). *See generally* Reid Carron & Kathlyn E. Noecker, *The Employer's Duty to Supply Financial Information to the Union: When Has the Employer Asserted an Inability to Pay?—or—(The Boss Says Times Are Tough: How Truitt Is)*, 8 LAB. LAW. 815 (1992).

77. Truitt, 351 U.S. at 153.

78. *See generally* Carron & Noecker, *supra* note 76, at 816–17.

79. National Labor Relations Act, 29 U.S.C. § 158(a)(5).

80. *Truitt*, 351 U.S. at 153.

81. *See generally* Carron & Noecker, *supra* note 76.

82. Under the U.S. system of labor law, legal disputes often center on differences of meaning in employers' statements made in collective bargaining, in union campaigns, and in other contexts.

83. United Paperworkers Int'l Union v. NLRB, 981 F.2d 861, 862 (6th Cir. 1992).

84. *Paperworkers*, 981 F.2d at 862.

needed to alleviate that competitive imbalance."[85] This, according to the court, was not a plea of inability to pay.[86] The court found the employer's negotiators had "disavowed any plea of poverty," and, accordingly, ruled that no unfair labor practice had occurred.[87]

B. *Notice of Plant Closings*

In 1975 the European Community (EC) approved a directive that requires employers of twenty or more workers to give advance notice of plant closings and mass layoffs ("collective redundancies"), and to bargain or consult with workers over these changes.[88] Thirteen years later, the United States, following Europe's lead, passed a statute modeled on the EC directive, the Worker Adjustment and Retraining Notification (WARN) Act.[89] The WARN Act, which covers most employers of over 100 employees, requires that covered employers give sixty days' notice to each employee (or to the employees' union, if the employer recognizes one) of any plant closing or mass redundancy ("mass layoff").[90] Additionally, the employer must disclose the roll-back to the "State dislocated worker unit . . . and the chief elected official of the unit of local government within which such closing or layoff is to occur."[91] Employers who violate the WARN Act are subject to civil lawsuits for back pay to each affected employee for each day of violation at the affected employee's regular rate, plus for benefits under the applicable employee benefit plan, "including the cost of medical expenses incurred during the employment loss which would have been covered under an employee benefit plan if the employment loss had not occurred."[92]

However, the WARN Act contains an exception: Employers may lay off workers without the required notice if the job loss "is caused by business circumstances that were not reasonably foreseeable as of the time that notice would have been required."[93] One 1993 court decision holds that this "not reasonably foreseeable" exception protects even a

85. *Id.* at 866.

86. *Id.*

87. *Id.*

88. European Community Directive 75/129/EEC. In 1992, after much debate, the EC amended and strengthened this directive. European Community Directive 92/56/EEC. The author has discussed these directives in Donald C. Dowling, Jr., *EC Employment Law After Maastricht: "Continental Social Europe"?*, 27 INT'L LAW. 1, 15–16 (1993). *See generally* Donald C. Dowling, Jr., *Worker Rights in the Post-1992 European Communities: What 'Social Europe' Means to U.S. Based Multinational Employers*, 11 NW. J. INT'L L. & BUS. 564, 598 (1991).

89. 29 U.S.C. §§ 2101–09. *See generally* Michele Floyd, Note, *The Scope of Assistance for Dislocated Workers in the United States and the European Community: WARN and Directive 75/129 Compared*, 15 FORDHAM INT'L L.J. 436 (1992).

90. 29 U.S.C. § 2101(a)(3), § 2102(a). A "mass layoff" under the WARN Act is a layoff of 33% of the work force if this is at least 50 employees, or a layoff of 500 employees, regardless of percentage. *Id.* § 2101(a)(3).

91. *Id.* § 2102(a)(2).

92. *Id.* § 2104(a)(1).

93. *Id.* § 2102(b)(2)(A).

defense contractor that laid off employees right after the government had canceled a defense contract, even though six months before the government had notified the contractor it was out of compliance with government rules.[94] The court held the government's cancellation of the contract was a "not reasonably foreseeable" surprise, notwithstanding the six months' prior notice of noncompliance.[95] As this case demonstrates, the "not reasonably foreseeable" exception to the WARN Act can prove quite useful to employers.

VI. Employee Bankruptcies and Insolvencies

Thus far, this article has dealt entirely with *employer* bankruptcies and insolvencies. However, some provisions of U.S. law apply to bankruptcies and insolvencies of *workers*. First and most relevant is section 525 of the Bankruptcy Code, which prevents employers from discriminating against workers who have filed for bankruptcy or are insolvent:[96]

> No private [nongovernment] employer may terminate the employment of, or discriminate with respect to employment against, an individual who is or has been a debtor under this title . . . or an individual associated with such debtor or bankrupt, *solely because* such debtor or bankrupt (1) is or has been a debtor under this title . . . ; (2) has been insolvent before the commencement of a case under this title or during the case but before the grant or denial of a discharge [in bankruptcy]; or (3) has not paid a debt that is dischargeable in a case under this title. . . .[97]

Under the employment-at-will doctrine, employers are free to discriminate against or discharge employees on any grounds except those grounds specifically carved out by law; employees are just as free to quit at any time, for any reason.[98] Increasingly, statutes carve out specific grounds in which discrimination is illegal. While the most often litigated antidiscrimination laws involve the "protected classes" of race, religion, national origin, age, disability, and sex, section 525 of the Bankruptcy Code creates a similar protection and elevates status as bankrupt, former bankrupt, or insolvent to the level of a "protected class."[99]

Yet this provision does not totally insulate bankrupts from discharge. Indeed, bankrupts have the heavy burden of proving that their bankruptcy or insolvency was the "sol[e]" motive behind their employ-

94. International Ass'n of Machinists v. General Dynamics Corp., 821 F. Supp. 1306 (E.D. Mo. 1993).
95. *Id.* at 1313.
96. 11 U.S.C. § 525.
97. *Id.* § 525(b) (emphasis added). A similar, older provision applies to *government* employers. *Id.* § 525(a).
98. This is the standard statement of the employment-at-will doctrine, which has its roots in early English law. The author has elsewhere discussed the doctrine and its common law origins. Donald C. Dowling, Jr., *A Contract Theory for a Complex Tort: Limiting Interference with Contract Beyond the Unlawful Means Test*, 40 U. MIAMI L. REV. 487, 496, 499–501 (1986), *reprinted in* 35 DEF. L.J. 503, 513, 517–19 (1986).
99. 11 U.S.C. § 525.

er's decision to discharge them.[100] In one case,[101] a consumer loan "coordinator" at a Chase Manhattan Bank branch in Puerto Rico authorized bank loans to her brother, her sister-in-law, and to employees of her husband's financially ailing bakery. The loan coordinator had told her relatives and the employees to say on their loan applications that their loans were for "home repairs," but the funds from these loans actually went to finance the husband's bakery,[102] and the sister-in-law's loan application was forged.[103] The loan coordinator ultimately filed for bankruptcy, after which she found an employment evaluation mentioning her financial problems; the bank, though, ultimately deleted this reference from her evaluation document.[104] When the bank later discovered the facts behind the bakery loans, it fired the loan coordinator, and she sued alleging discrimination because of her status as a bankrupt.[105] One witness for her testified that a bank manager had said the firing was because of the coordinator's bankruptcy status,[106] but the court nevertheless held the loan coordinator had not proved her bankruptcy status was the sole motive behind her firing.[107] The court put great weight on the "solely because" clause in the bankruptcy antidiscrimination statute.[108] This clause, which does not appear in other antidiscrimination statutes, makes bankruptcy-status discrimination claims especially difficult to prove.

Besides this statutory protection of bankruptcy and insolvency status, many states regulate discrimination against employees because of the employees' status as being subject to garnishment orders (that is, court orders allowing creditors to collect debts directly from a debtor's employer).[109] Garnishment orders inconvenience employers, and employers have been known to discharge employees subject to them. To protect garnished employees, many states regulate, in different and sometimes peculiar ways, employers' freedom to discipline workers for being subject to garnishments. For example, an Ohio statute says: "No employer shall discharge an employee solely because of the successful garnishment of such employee's personal earnings by only one judgment creditor in any twelve-month period."[110]

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100. *Id.* § 525(b).
101. Laracuente v. Chase Manhattan Bank, 891 F.2d 17 (1st Cir. 1989).
102. *Id.* at 19.
103. *Id.*
104. *Id.* at 20.
105. *Id.*
106. *Laracuente*, 891 F.2d at 20.
107. *Id.* at 24.
108. *Id.* at 21–24.
109. *See* 8 EMPLOYMENT DISCRIMINATION COORDINATOR *GARNISHMENT* ¶ 110,371 (Warren Gorham Lamont 1991 & Supp.)
110. OHIO REV. CODE ANN. § 2716.05 (Baldwin 1991). *See generally* Greeley v. Miami Valley Maint. Cont., Inc., 551 N.E.2d 981 (Ohio 1990) (similar Ohio statute protecting employees subject to child support orders).

What this statute does not say is interesting: By inference, this statute allows an Ohio employer to *discipline* an employee short of discharge for successful garnishments, and to discharge an employee for *unsuccessful* garnishments, for successful garnishments by *more than one judgment creditor*, and for garnishments from only one judgment creditor if these garnishments *extend over twelve months*. Many of the garnishment statutes in other states contain similar peculiarities.

Additionally, an even more curious garnishment-protection doctrine exists under federal race discrimination law, which renders illegal any employer's facially neutral garnishment discharge policy[111] which has a "disparate impact" on protected minorities.[112] The theory behind this doctrine presupposes that racial minorities might be subject to garnishments at a disproportionally high rate—an assumption which itself may well appear discriminatory.

A final issue relating to worker insolvencies is the issue of trade union bankruptcies. For reasons shrouded in history, trade unions (like churches and fraternal societies) are unincorporated associations with no legal identity apart from their individual members. When a union petitions for bankruptcy, an issue therefore arises as to whether the union can invoke protections under federal bankruptcy laws. Elevating the practical over the technical, courts hold that the bankruptcy laws cover even unincorporated labor unions and their local organizations.[113]

VII. Conclusion

Because U.S. bankruptcy law and employment law do not intersect at any single traditional legal discipline, the study of this area passes through various branches of the law. As a general rule, most bankruptcy/employment issues arise under the U.S. Bankruptcy Code, which furthers the strong United States tradition toward ensuring that employees (as opposed to contractors) receive payment for their earned wages. Areas of law apart from the Bankruptcy Code which come into play include the collective bargaining law, the plant closing law, matters of state law regarding garnishment, and even federal race discrimination laws. Overall, U.S. law generally protects workers at the expense of employers, both in employer bankruptcies and in workers' bankruptcies.

111. An example would be a policy under which any employee subject to two or more garnishments from two or more garnishment creditors would be discharged.

112. See cases collected in Allan L. Schwartz, Annotation, *Garnishment Discharge Policy of Employer as Unlawful Employment Practice Violative of Title VII of Civil Rights Act of 1964*, 26 A.L.R. FED. 394 (1976 & Supp. 1993).

113. *See, e.g.*, Highway & City Freight Drivers Local 600 v. Gordon Transports, Inc., 576 F.2d 1285 (8th Cir.), *cert. denied*, 439 U.S. 1002 (1978).